Direct Loans

William D. Ford Federal Direct Loan Program

CONSOLIDATING DEFAULTED LOANS

Yes, borrowers may consolidate their defaulted student loans under certain conditions.

Issues to Consider

- ➤ How important is a clean credit rating to the borrower?
- ➤ Can the borrower rehabilitate the defaulted loan?

Repayment Choices

To consolidate a defaulted loan, a borrower must either agree to repay under the Income Contingent Repayment (ICR) Plan or make “satisfactory repayment arrangements” — three consecutive monthly payments — with the prior lender.

Rehabilitation or Consolidation?

A defaulted loan is reported to credit bureaus and remains on a borrower’s credit report for up to seven years. A borrower may want to “rehabilitate” a defaulted loan, which will remove the default notation from a credit report. Rehabilitating a Direct Loan requires 12 consecutive monthly payments; rehabilitating a Federal Family Education Loan (FFEL) requires 12 payments and the reselling of the loan.

Consolidating a defaulted loan will result in a credit report bearing the notation that a defaulted loan was “paid in full.” This notation will remain on the credit report for up to seven years. While a “paid in full” notation is preferable to an unpaid default, there is no guarantee that lenders will not deny future credit, such as mortgages, auto loans or credit cards, because of this notation.

When a defaulted Direct Loan or FFEL is included in a Direct Consolidation Loan, up to 18.5 percent in collection costs will be added to the outstanding principal and interest.

Both rehabilitation and consolidation will reinstate a borrower’s eligibility for Title IV funds.

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